

Reshaping the vision

Emerging stronger from market transformation

**Transaction
banking:**
*Reshaping your
business to take
advantage of the
shift in global
commerce,
clearing and
custody*

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Transaction banking is gearing up for transformation, creating valuable commercial opportunities for nimble and farsighted banks and opening up the risk of competitive marginalisation for others.

Key developments include the rapid increase in emerging-to-emerging market commerce and the growing proliferation of virtual marketplaces and new digital payment platforms. Transaction banks must find ways to follow their customers and keep pace with their changing demands or risk losing revenues and relevance. At the same time, technology could help transaction banks to interact more closely with their customers and develop more effective ways to help them trade internationally and manage their working capital.

On the securities side, fund managers are adopting a more cautious approach to the custody of their assets and how their prime broker makes use of these assets. Reform of over-the-counter (OTC) derivative trading and the increased emphasis on central clearing are also driving the development of new business models, with the increasing demand for collateral and associated collateral services opening up significant revenue potential.

We believe there are three key questions that banks will need to address if they're to sustain competitive relevance in this rapidly changing environment:

1. How do you choose and get closer to your chosen customers – who will be your key customers in 2020 and how can you develop a more profitable relationship?
2. How will you manage risk and capital more effectively – what is the impact of regulation on your business model and how can you develop a more favourable and sustainable balance between risk and reward in this new environment?
3. How will you keep pace with market developments – what competitive advantages can you bring to bear and what resources and technology will be required to support this?

Members of our global transaction banking team have written a series of special articles, examining the key developments and their competitive implications. Here we provide a summary of the main points.

For a full version of the articles please visit www.pwc.com/transactionbanking

Closer to your customers

Sustaining profitability in an increasingly commoditised market

The shock of the financial crisis has made sustaining liquidity the paramount priority for customers. Indeed, the past year has seen a marked rise in the number of customers looking to switch transaction banking partners if they can't support their financing requirements. Even the best cash management banks could miss out if they can't support a client's financing needs. The challenges this creates for transaction banks are heightened by the fact that many corporate treasurers are coming to see payments, collections, trade finance and other core aspects of transaction banking as virtual commodities, in which the services of different banks are largely interchangeable.

Sustaining profitability in this highly competitive marketplace depends on being able to deliver the product and funding solutions that corporates prize and are prepared to pay a premium for. The banks that are going to lead the way are already breaking down the silos between credit and transactions to develop mutually supporting solutions for their customers. The high value attached to liquidity also provides opportunities to market more sophisticated working capital solutions to mid-size corporations (circa \$500 million annual turnover), with the latest innovations continuing to attract favourable margins, despite the aggressive price cutting seen elsewhere in the marketplace.

Getting the most out of your sales force

With win rates of less than 30%, the sales forces of most transaction banks are significantly underperforming other comparable sectors. Smart banks are rising to the challenge by seeking to develop a more informed, proactive and actively managed approach to sales. The basis is more actionable client feedback gained through surveys of client staff at all levels of the organisation. The questions cover a range of dimensions including value, quality and ease of doing business with the bank, rather than just indicating whether the client is broadly satisfied or not. This allows the bank to identify where specific improvements could be made. For example, a bank was getting a high rating for quality and value, but a poor score for how easy it was to deal with. Remedial action focused on how to improve client service and after-sales support.

Crucially, the feedback can also help to improve client understanding and develop a more targeted approach to account planning. Rather than passively waiting for a request for proposal, the relationship manager should have enough insights into the client's business to anticipate what they want and make sure the bank is in a position to deliver. The win rate should significantly improve as there is greater certainty about what the client needs and more time to develop an effective solution.

Managing risk and capital more effectively

Getting to grips with Basel III

The latest proposals for Basel III are set to radically change the capital and liquidity provisions for trade finance, leading to potentially significant extra costs for banks and their customers. While some institutions may choose to withdraw from an area of business they see as offering insufficient return on capital, trade finance will continue to be a key consideration in businesses' choice of banking partners. It will therefore be important to develop cost-effective ways to sustain trade support, including new structures, more efficient processes and closer collaboration with partner banks.

As such, Basel III may well be the catalyst that finally leads to a take-off in supply chain finance (SCF). SCF would allow banks to pass on much of the risk to larger buyers and hence curtail their capital demands. It would also strengthen relationships across the supply chain and provide openings to other business opportunities. For buyers, the benefits include improved working capital management. Suppliers would gain from increased liquidity and more assured cash flows.

Cooperation with partner banks has always been an essential element of trade finance. As some banks choose to scale back trade finance or focus their capital on particular sectors or territories, cooperation /outsourcing is going to be even more important in providing the breadth of service needed to maintain a commercial relationship, or meet government expectations. This will in turn demand more effective partner analysis and greater expertise in managing commercial networks.

Prime custody – response to a growing market need

The Bear Stearns and Lehman defaults have led asset managers and hedge funds to demand greater transparency over where their assets are held and how they're segregated and rehypothecated. The reform of OTC derivatives markets is also leading to the development of broker-clearing models, which are increasing demand for collateral and associated collateral services. In turn, traditional asset managers are moving away from long-only investment strategies to expand assets under management and increase fees, while at the same time exploring solutions to meet the need for safe and secure custodial services.

The result is a variety of solutions collectively known as prime custody, which fuse the roles of custody and prime broker:

- Broker using a third-party custodian to provide segregation of unencumbered assets.
- Build-out of prime business on top of custody in an in-house custody function.
- Outsource of asset servicing and focus on financing and client service.

Each of these models enables the custodian to assume a different role in the prime value chain. The challenge is how to provide the required level of security for clients and effectively segregate assets, as well as how to use client assets to collateralise positions in the most efficient way. A recent PwC survey of buy-side needs from their clearing broker highlighted collateral management and the ability to contain costs as key differentiators.

Capitalising on new collateral demands

Regulatory developments are changing collateral requirements and making the efficient management of collateral a crucial competitive issue. Key developments include the move to central clearing of credit default and interest-rate swaps, which is likely to require more and possibly higher quality collateral than would be the case within a bilateral trade. The market is also facing the impact of tougher capital and liquidity demands, new intraday reporting requirements, and greater controls over how collateral is used and segregated.

As a result, forward-looking banks are pursuing ways to develop a more transparent, comprehensive and centralised approach to the management of collateral, which seek to use available collateral more effectively, reduce funding costs and offset risks. This in turn is likely to require greater automation and the elimination of product-focused silos.

There are also opportunities to expand the collateral offering to help clients trade more efficiently and reduce costs. This includes collateral transformation, in which higher quality collateral is deployed in exchange for lower tier assets. It also includes securities financing, in which collateral is lent to various parties to maximise profitability.

Keeping pace with market developments

Gearing up for the digital revolution

The advent of smart phones, social media and virtual marketplaces has already transformed business-to-consumer commerce and now the way businesses transact, market their products and interact with each other is set for a similar shake-up.

Virtual platforms are capturing an ever-growing proportion of business-to-business commerce and creating ever-higher expectations for ease of access and usability. As virtual marketplaces proliferate, they're providing the financial infrastructure and trade guarantees that used to be the preserve of transaction banks. Recent months have also seen the launch of a new social media currency trading platform, which allows users to trade online, follow other traders and share tips in a chat room, all for free.

In turn, social media and mobile banking are shaping the way customers interact with financial services providers and creating openings for social media, telecommunications companies and other non-bank competitors to move into the payment and trade finance markets.



This digital revolution opens up huge opportunities for transaction banks, allowing them to engage more closely with their customers, tap in to rapidly expanding trade flows and extend the boundaries of commerce. Yet, it also raises expectations about ease of access and usability. Banks' ability to respond will be impeded by the weight of their legacy systems. They're also going to be facing increasing competition from mobile networks, internet service providers and other nimble new entrants looking to extend their grip on digital communications to the trading and transaction markets.

Turning cyber security into competitive advantage

The conventional approach to cyber security isn't working. It's ill-equipped to keep pace with the constantly evolving and escalating threat of cybercrime. The 'lockdown' approach to security is also preventing institutions from making the most of mobile, social media and other digital opportunities.

Keeping pace with criminal and commercial developments is going to require a more proactive approach to detecting vulnerabilities and developing the technology to counter them. It's also going to require a change of culture, in which business and security

strategies are developed in parallel, and security becomes everybody's business. Banks that get this right will be able to turn security from a barrier to an enabler of digital business and ultimately a key source of competitive differentiation.

Trading blocs: Where next for stock-exchanges?

Recent months have seen a flurry of merger announcements in the global exchange sector. If they go ahead, they could accelerate the consolidation in an already increasingly concentrated sector in Europe and North America.

Leading stock-exchange groups are looking to consolidation to help them trade across all continents and time zones. As IT costs rise and major groups face growing competition from new entrants, consolidation also allows them to shore up market share and develop economies of scale. In turn, the tie-ups can also help them to expand across the value chain. This includes developing their presence in derivatives and providing a full pre- to post-trading service where regulation allows. While it's trading that tends to attract the most attention, post-trading settlement and custody services are often the most complex and valuable areas of the business.

As the latest round of stock-exchange consolidation across Europe and North America comes to a head, the only remaining questions are how many exchanges the market can support and what happens to the handful of national exchanges that have retained their independence. As the axis of growth and market activity shifts South and East, the emerging markets are set to be the focus of the next wave of transformational deal-making within the exchange sector.



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